BEFORE

THE PUBLIC SERVICE COMMISSION OF

SOUTH CAROLINA

DOCKET NO. 95-715-G - ORDER NO. 95-1649

NOVEMBER 7, 1995

IN RE: Application of Piedmont Natural Gas Company for an Adjustment of its Rates and Charges and for Approval of Revised Depreciation Rates.	) ORDER APPROVING) NEW RATES AND) CHARGES AND) DEPRECIATION RATES

I. INTRODUCTION

This matter comes before the South Carolina Public Service Commission (hereinafter the "Commission") by way of the Application of Piedmont Natural Gas Company, Inc. (hereinafter "the Company"), filed on May 8, 1995, for an increase in certain rates and charges for natural gas services provided by the Company in South Carolina and for approval of revised depreciation rates. The Application was filed pursuant to S.C. Code Ann.§58-5-240 (Supp. 1994), as amended, and R.103-830, et seq. of the Commission's Rules and Regulations.

On May 17, 1995, the Commission's Executive Director instructed the Company to cause to be published a prepared Notice of Filing and Hearing once a week for three consecutive weeks in newspapers of general circulation in the Company's service area. The Notice of Filing and Hearing indicated the nature of the Company's Application and advised all interested parties desiring to participate in the proceeding of the manner and time in which to file the appropriate pleadings. It also indicated that a hearing would be held in the instant proceeding. The Company was required to notify directly all customers affected by the proposed rates and charges. On July 13, 1995, the Company furnished affidavits and certification demonstrating that the Notice of Filing and Hearing had been duly published and mailed to each customer affected by the rates and charges proposed by the Company's Application.

A Petition to Intervene was filed with the Commission on behalf of Philip S. Porter, Consumer Advocate for the State of South Carolina (hereinafter the "Consumer Advocate").

Pursuant to notice given in accordance with the applicable provisions of law and with the Rules and Regulations of the Commission, a public hearing commenced on October 9, 1995 and continued on October 10, 1995, Honorable Rudolph Mitchell presiding. Appearances were entered by John E. Schmidt, Esquire, and Jerry W. Amos, Esquire, on behalf of the Company; Philip S. Porter, Esquire, Nancy Vaughn Coombs, Esquire, and Hana Pokorna-Williamson, Esquire, on behalf of the Consumer Advocate; and F. David Butler, Esquire, and Catherine D. Taylor, on behalf of the Commission Staff.

The Company presented the direct testimony of four witnesses on its behalf: (1) John H. Maxheim, Chairman of the Board, President and Chief Executive Officer of the Company; (2) Barry L. Guy, Vice President and Controller of the Company; (3) Dr. Donald A. Murry, Economist with C.H. Guernsey & Company; and (4) Ware F. Schiefer, Executive Vice President of the Company. Messrs. Guy, Murry and Schiefer also presented rebuttal testimony on behalf of the Company. In addition, the Company presented the rebuttal testimony of (1) Ann H. Boggs, Director - Gas Accounting of the Company; and (2) Donald S. Roff, Director of Deloitte & Touche LLP.

The Consumer Advocate presented the direct testimony of four witnesses: (1) Annette L. Yontz, consultant; (2) Dr. Michael J. Ileo, President and Chief Economist of Technical Associates, Inc.; (3) David C. Parcell, Vice President and Senior Economist of Technical Associates, Inc.; and (4) Glenn A. Watkins, Vice President/Senior Economist of Technical Associates, Inc. Messrs. Ileo and Watkins also presented surrebuttal testimony on behalf of the Consumer Advocate.

The Commission Staff presented the direct testimony of three witnesses: (1) Dr. James Edward Spearman, Assistant Public Utilities Economist; (2) Brent L. Sires, Utilities Rate Analyst; and (3) Norbert M. Thomas, Public Utilities Accountant.

In the consideration of the evidence in the record before us, the Commission has remained mindful of our statutory responsibility, delineated by S.C. Code Ann.§§58-5-210, et seq. (Law Co-op. 1977), to determine the lawfulness and reasonableness of rate adjustments proposed by public utilities. In the due exercise of the responsibility and for the reasons more fully discussed herein, the Commission has determined that an overall rate of return on rate base resulting from the Company's gas operations of 10.77%, based on adjusted test year operations, is fair and reasonable, and that in order to have the opportunity to achieve such return, the Company would have required additional annual revenues of $7,807,207. Founded upon the Company's test year operating and financial experience as adjusted, the Commission has concluded that the allocation of the additional revenue, as provided herein, meets the applicable statutory criteria and is consistent with other pertinent legal pronouncements. Federal Power Commission v. Hope Natural Gas Co., 320 U.S. 591, 64 S.Ct. 281, 88 L.Ed.2d 333 (1944); Bluefield Water Works & Improvements Co. v. Public Service Commission of West Virginia, 262 U.S. 679, 43 S.Ct. 675, 67 L.Ed. 1176 (1923); Southern Bell Telephone and Telegraph Company v. Public Service Commission of South Carolina, 270 S.C. 590, 244 S.E.2d 278 (1978).

II. THE COMPANY

The Company is incorporated under the laws of the State of North Carolina and is duly authorized by its Articles of Incorporation to engage in the business of transporting, distributing and selling natural gas. It is duly domesticated and is engaged in conducting the business above mentioned in the States of South Carolina, North Carolina and Tennessee. It is a public utility under the laws of South Carolina, and its public utility operations in South Carolina are subject to the jurisdiction of the Commission. See, S.C. Code Ann.§58-3-140(A) (Supp. 1994). The Company provides its natural gas service to 18 cities and towns in South Carolina, including Greenville, Spartanburg and Anderson. The Company provides its natural gas services to approximately 90,000 customers in South Carolina.

III. TEST YEAR

A fundamental principle of the ratemaking process is the establishment of a test year period. Ideally, such a period should be represented by the most recent twelve months preceding the date of filing a rate adjustment application for which data is available. While the rates and charges finally approved will have prospective effect only, this Commission has routinely adhered to the view that the immediate past experience, characterized by identifiable operating results for a complete twelve-month period, provides the most reliable guide for the immediate future. The reliance upon the test year concept, however, is not designed to preclude the recognition and use of other historical data which may precede or postdate the selected twelve-month period.

Integral to the use of an average year, representing normal operating conditions to be anticipated in the future, is the necessity to make normalizing adjustments to the historic test year figures. Only those adjustments which have reasonable and definite characteristics and which tend to influence reflected operating experience are made to give proper consideration to revenues, expenses and investments. Southern Bell, supra, 244 S.E.2d at 284. Adjustments may be allowed for items occurring in the historic test year, but which will not recur in the future, or to give effect to items of an extraordinary nature by either normalizing or annualizing such items to reflect more accurately their annual impact; or to give effect to any item which should have been included or excluded during the historic test year.

In the instant proceeding, the Company's Application was based on actual operating experiences for the twelve-month period ending January 31, 1995, and included financial and operating information for that period. The Commission Staff and the

Consumer Advocate likewise presented their evidence generally within the context of the same test period. In consideration of the relative proximity of the commencement of this proceeding, the Commission finds the twelve months ended January 31, 1995, to be a reasonable period for which to make our ratemaking determination herein.

IV. ACCOUNTING AND PRO FORMA ADJUSTMENTS

The Company filed with its Application a schedule showing its operating revenues, operating expenses, net operating income, net operating income for return, net plant in service and return on investment for the test period. In addition, the Company filed schedules showing certain accounting and pro forma adjustments to the test period information. The Commission Staff and the Consumer Advocate proposed certain adjustments to the information filed by the Company. This Order will discuss in detail only those accounting and pro forma adjustments in which the Staff or the Consumer Advocate proposed a different regulatory treatment than the Company. All adjustments on which the Company and Staff agree are hereby adopted.

A. Adjustments proposed by the Staff

1. Adjustment to Revenue to Reflect the Impact of Demand Side Management (DSM) Programs.

The Company annualized DSM revenue based on estimated DSM volumes from May 1, 1995 through October 31, 1995, resulting in an increase in revenue of $68,383. The Staff adjusted test year revenues and expenses to reflect actual DSM expenditures that occurred during the months of July and August 1995 annualized.

The Staff's adjustment increased revenue by $14,328. At the hearing, the Company agreed to the Staff's adjustment. In keeping with his proposal that DSM activities should be excluded from this proceeding, the Consumer Advocate did not propose an adjustment to revenues for DSM-related volumes.[1] The Commission concludes that the Staff's method of determining the amount of revenue realized from DSM programs is consistent with the Commission's past practice of annualizing the latest known level of revenues not fully reflected in test period operations. For these reasons, the Commission finds and concludes that the Staff's adjustment is appropriate.

2. Adjustment to Cost of Gas to Reflect Current Rates and Other Gas Cost Changes.

The Company and the Staff decreased cost of gas to reflect current rates reflected in PGA-78 effective February 1, 1995 in the amount of $5,239,614 and $5,266,857, respectively. The Company adjusted cost of gas to reflect estimated DSM volumes from May 1, 1995 through October 31, 1995, resulting in an increase in cost of gas of $34,948. Staff adjusted cost of gas to reflect actual DSM volumes that occurred during the months of July and August 1995 annualized. The Staff's adjustment increased cost of gas by $7,705. At the hearing, the Company agreed to the Staff's adjustment. Consistent with this proposal that DSM activities should be excluded from this proceeding, the Consumer Advocate proposed no adjustment to cost of gas related to DSM volumes. The

1. The Consumer Advocate's proposal to exclude all DSM-related matters from the proceeding is discussed in a later section of this Order.

Consumer Advocate also contends that the Company's method of normalizing for weather is not approprite and, therefore, that the Company's cost of gas should be increased to reflect the cost of the additional volumes estimated by the Consumer Advocate. For the reasons set forth below in the discussion of the Consumer Advocate's adjustments, the Commission does not agree that DSM activities should be excluded from this proceeding, or that the Commission should change its method of computing weather normalized volumes; therefore, the Commission finds and concludes that the Staff's adjustment to cost of gas is appropriate.

3. **Adjustments to Operating and Maintenance Expenses.**

The Staff proposed a number of adjustments to operating and maintenance expenses that differ from the Company's filing. These adjustments include (a) an adjustment to annualize wages and salaries as of July 1995, (b) an adjustment to the expenses associated with the Company's Payroll Investment Plan based on pro forma wages and salaries, (c) an adjustment to pension expense based on pro forma wages and salaries, (d) an adjustment to uncollectibles based on pro forma revenue, (e) an adjustment to eliminate certain membership fees and dues and other expenses not relating to operations, (f) an adjustment to rate case expenses, (g) an adjustment to the expenses for the Long-Term Incentive Plan, (h) an adjustment to reflect annualized costs associated with DSM programs, (i) an adjustment to amortize deferred environmental costs over a 3-year period, (j) an adjustment to eliminate salaries and expenses associated with lobbying activities and the lobbying portion of the AGA dues, and (k) an adjustment to the allocation of officers' salaries and vehicle expenses to non-utility operations. Each of these adjustments is detailed in the Commission Staff Report and in the testimony of Staff witness Norbert Thomas. Most of the differences between the Company and the Staff relate to the fact that the Staff's investigation occurred after the filing of the Application and the Staff was able to rely on actual data; whereas, the Company had to rely on estimated data for some items. At the hearing, the Company agreed not to contest any of these adjustments. With the exception of the DSM expenses adjustment discussed below, no other party offered any evidence with respect to these adjustments, therefore, the Commission finds and concludes that each of these proposed adjustments is appropriate.

4. Adjustment to Depreciation Expense.

The Company annualized Depreciation Expense based on Plant in Service at January 31, 1995 for an increase of $172,101. Additionally, the Company requested approval of new depreciation rates based on a study performed in 1994 and made a part of the Company's application. The new depreciation rates result in an increase in depreciation expense of $1,090,777. The Company also increased Depreciation Expense by $217,906 to reflect depreciation on estimated plant additions through August 31, 1995. The total depreciation expense adjustment proposed by the Company was $1,480,784. The Staff proposed a total depreciation expense adjustment of $1,611,443. The difference between the Company's adjustment and the Staff adjustment relates to the fact that the Company used estimated plant additions through August 31, 1995 and the Staff used actual additions through July 31, 1995. At the hearing, the Company agreed to the Staff's adjustment. The Consumer Advocate did not object to the method of computing the depreciation expense adjustment, but did object to the new depreciation rates proposed by the Company and recommended by the Staff. In addition, the Consumer Advocate proposed to capitalize OPEB expenditures of $53,434, which results in an increase to depreciation expense of $1,850. At the hearing, the Company agreed to the Consumer Advocate's proposal to capitalize OPEB expenditures and to increase depreciation expense. For the reasons set forth below under our discussion of the Consumer Advocate's adjustments, the Commission finds that the depreciation rates proposed by the Company and recommended by the Staff are appropriate. The Commission further finds and concludes that it is appropriate to compute depreciation expense on the actual plant additions rather than upon the estimated plant additions. Therefore, the Commission finds and concludes that the Staff's proposed adjustment of $1,611,443 and the Consumer Advocate's proposed adjustment of $1,850, totaling $1,613,293, are appropriate.

5. Adjustment to General Taxes.

The Company adjusted Property Taxes by $551,033 based on end-of-period plant including estimated additions through August 31, 1995. The Staff increased this adjustment to $597,496 to reflect actual plant additions through July 31, 1995. At the hearing, the Company agreed with the Staff's adjustment. The Commission finds and concludes that it is appropriate to adjust property taxes to reflect actual plant additions, therefore, the Commission finds and concludes that the Staff's adjustment, agreed to by the Company, is appropriate.

6. Adjustment to Interest on Customer Deposits.

The Company did not propose an adjustment to Interest on Customer Deposits. The Staff proposed an adjustment of $17,609. At the hearing, the Company agreed to the Staff's adjustment, and no party opposed the adjustment. The Commission finds and concludes that the Staff's adjustment is consistent with past Commission decisions and is appropriate for this proceeding.

7. Adjustment to Allowance for Funds Used During Construction (AFUDC).

The Staff annualized AFUDC on the remaining balance of the end-of-period Construction Work In Progress (CWIP) not yet closed to Plant in Service for total AFUDC as adjusted of $65,042. This required an adjustment of ($155,233). At the hearing, the Company stated that it did not oppose this adjustment. No other party offered any evidence on this adjustment, and the Commission finds and concludes that the adjustment is appropriate.

8. Adjustment to Income Tax Expenses.

With one exception, the Company agreed with the Staff's calculation of income taxes. The Staff did not include AFUDC in its calculation of income taxes. The Company contends that AFUDC should be included because it is taxable and the amount in operating income is before taxes. The Company contends that excluding AFUDC from the calculation of income taxes overstates operating income. At the hearing, the Staff agreed with the

Company that AFUDC should be included in the calculation of income taxes. No other party offered any evidence on this adjustment. For the reasons stated by the Company, the Commission finds and concludes that AFUDC should be included in the calculation of income taxes.

9. Adjustment to Customer Growth.

The Company computed a Customer Growth Factor of 4.02%. The Consumer Advocate accepted the Company's Customer Growth Factor. The Staff computed a Customer Growth Factor of 4.12%. At the hearing, the Company agreed with the Staff. The Commission finds that the Customer Growth Factor of 4.12% was calculated in accord with our past practice and is reasonable in this case; therefore, the Commission finds and concludes that a Customer Growth Factor of 4.12% is appropriate and should be applied to the operating income before customer growth found appropriate in this order.

10. Adjustments to Rate Base.

The Company and the Staff differed on the treatment of two items in rate base. The first difference is whether imprest bank accounts, petty cash and employee travel advances should be included in cash working capital. The second difference relates to the valuation of natural gas inventory.

a. Imprest Bank Accounts, Petty Cash and Employee Expenses.

The Company included $51,836 of imprest bank accounts, petty cash and employee travel advances in cash working capital. Company witness Barry Guy testified that the $51,836 represents an actual investment made by the Company and that the items making up this amount have been included in past general rate cases before this Commission, including the Company's last general rate case. The Staff agreed that the $51,836 represents an actual investment, but contended that the formula working capital allowance picks up this amount. Although the Commission recognizes that there may be occasions in which it needs to review and change its past policies, it does not believe that sufficient evidence has been presented on this issue to warrant a change at this time. Company witness Barry Guy testified that the Company attempted to file this rate case in accord with past pronouncements of the Commission. In those few cases, where it appeared that the Company did not do so, it agreed at the hearing with the Staff's adjustments that complied with the Commission's past pronouncements. Absent clear and convincing evidence that the Commission's past pronouncements should be changed, it would not be appropriate to do so, especially in light of the Company's efforts to comply with these past pronouncements. The Commission finds and concludes that the $51,836 of imprest bank accounts, petty cash and employee travel advances represents investments made by the Company and that it is appropriate to include this amount in cash working capital in accord with our past pronouncements, and the fact that we believe such methodology is also appropriate for use in this case.

b. Value of Natural Gas Inventory.

The Staff reduced Gas in Inventory by $2,805,225. This reduction relates to two different items. First, $1,608,122 relates to the Company's proposal to include prepaid gas costs related to cycle billing. Company witness Ann Boggs testified that the Company believes that prepaid gas costs related to cycle billing should be included in rate base because they represent gas costs incurred by Piedmont on behalf of its customers that will not be billed until a later date and, therefore, require an investment by the Company. At the hearing, however, Ms. Boggs testified that since the Company had not requested that this item be included in rate base in past rate cases before this Commission, the Company would agree to the Staff's adjustment. We believe that the adjustment is correct in the present rate case also. Therefore, the Commission finds and concludes that the Staff's adjustment of $1,608,122 is appropriate.

The second item included in the Staff's proposed reduction to rate base relates to how gas inventory is valued. The Company used the 13-month average of storage volumes, priced at the current benchmark cost of gas plus demand costs. The Staff used the 13-month average dollar value of gas in inventory. Ms. Boggs testified that she believes the Company's method of calculating the inventory value is correct because (1) it is consistent with the method used and approved by this Commission in previous cases, (2) the inventory volumes and dollars used by the Staff have been withdrawn and replaced subsequent to the determination of their value, (3) the benchmark cost used by the Company represents a reasonable known and measurable change, (4) the Commission has generally recognized known and measurable changes, and (5) inventory and the valuation thereof is different from certain other rate base items because its valuation changes as gas is withdrawn and replaced. For the reasons stated by Ms. Boggs, the Commission finds and concludes that it is appropriate to value gas inventory using the 13-month average of storage volumes, priced at the current benchmark cost of gas plus demand costs in accord with our past practice. We believe past practice is appropriate in the present rate case also.

11. Adjustment to Return on Common Equity.

The last item on which the Company and the Staff differ is the appropriate return on common equity. Since the Consumer Advocate also offers testimony on return on common equity, this issue will be addressed following a discussion of the items on which the Company and the Consumer Advocate differ.

B. Adjustments proposed by the Consumer Advocate.

1. Adjustment to DSM Expenses.

The Company included $845,900 of demand side management (DSM) costs in its expenses. The Staff included $847,866 of DSM costs and this amount was agreed to by the Company. The Consumer Advocate recommends that these expenses be disallowed. The Consumer Advocate gives two reasons for its recommendation. First, the Consumer Advocate contends that the inclusion of these DSM expenses is inconsistent with the stipulation entered into by the Company and the Staff and approved by the Commission in Docket No. 93-787-G. Second, the Consumer Advocate contends that these DSM expenditures should be disallowed because they were not spent during the test period. The Commission disagrees with the Consumer Advocate on both points.

With respect to the Consumer Advocate's first argument, the stipulation was signed by the Company and the Staff. Both of these parties agree that the stipulation permits the Company to recover these DSM costs in this proceeding. The Consumer Advocate elected not to sign the stipulation. The Commission believes that the intent and understanding of the parties who signed the stipulation is the best evidence of the meaning of the stipulation. Furthermore, it is clear that this Commission understood and approved the intent of the Company and the Staff as expressed in the stipulation. On page 9 of our Order No. 95-154, issued in Docket No. 93-787-G on January 27, 1995, we stated the following:

> "It should be stated that the Stipulation between the Company and the Staff contains a cost-recovery mechanism that would allow Piedmont to seek recovery costs for DSM and/or supply-side options within Piedmont's IRP, within its next general rate case, along with costs of IRP development. The Commission believes that this is appropriate, and that the Company-Staff Stipulation with regard to cost-recovery is hereby adopted with the rest of the Company-Staff Stipulation."

In short, the Consumer Advocate's interpretation of the stipulation is contrary to the intent of the parties who entered into the stipulation and is contrary to our Order No. 95-154.

With respect to the Consumer Advocate's second argument, the Commission is aware that the Company did not incur any of the DSM costs during the test period. As shown by the testimony of Staff witness Brent Sires, however, the Company did incur DSM costs during the months of July and August 1995. The Staff annualized these expenditures in its adjustments to the filing, and the Company agreed to this method of determining the on-going level of DSM costs. The Commission has on many occasions in the past recognized that when the Company does not have a full 12 months of costs, a reasonable method of determining annual costs is to annualize the costs which the Company does have, and the Commission finds that this is a proper method in this case to measure annual DSM costs.

The Commission also notes that the Company elected not to introduce the prefiled rebuttal testimony of the Company witness who offered rebuttal testimony on DSM costs. Counsel for the Company stated that the Company was satisfied with the record on this issue and, in the interest of shortening the hearing, elected to rely on that record. Since the record includes the stipulation entered into by the Company and the Staff, the order of this Commission approving that stipulation and the testimony of Staff witness Brent Sires of the DSM expenses actually incurred by the Company during July and August 1995, the Commission agrees that the record contains all of the evidence required to support the findings and conclusions reached by the Commission on this issue. For all of the above reasons, the Commission finds and concludes that the Consumer Advocate's proposed adjustment to remove DSM costs is not appropriate under the facts and circumstances of this case.

2. Adjustment to Capitalize OPEB Expenses.

The Consumer Advocate proposed to reduce OPEB expenditures by $53,434 and, concurrently, to reflect the capitalization and depreciation of this amount. At the hearing, the Company agreed to these adjustments. We have previously found that the adjustment to depreciation is proper. Since no party objected to the Consumer

Advocate's proposal to capitalize these expenditures, the Commission finds and concludes that the proposal is appropriate.

3. Adjustment to Rate Base for Balance in PGA Deferred Account.

The Consumer Advocate proposed to reduce rate base by $3,000,000 because the Company from time to time has amounts in its PGA deferred account provided by customers. This matter was recently before the Commission in the Company's most recent PGA review case in Docket No. 95-160-G. In our Order No. 95-1461 issued in that case on August 22, 1995, we expressed our concern about the reduction to rate base and stated that we would consider the matter in the Company's next rate case. We also suggested that a possible way of addressing this issue would be to compute interest on a floating balance in the account.

The Company admits that from time to time it has amounts provided by its customers in the deferred account, but points out that the balance varies from time to time. Company witness Ann Boggs offered an exhibit showing that during the period March 1994 to March 1995, the balance in the deferred account varied from a positive balance of $1,534,070 to a negative balance of $3,722,999. A positive balance means the Company's investors are supplying funds to offset an undercollection of gas costs from customers, and a negative balance means the Company's customers are supplying funds in the form of an overcollection of gas costs.

The Company contends, and the Commission agrees, that a reduction in rate base of $3,000,000 would at times penalize the Company and at times penalize customers. If we were to reduce rate base by $3,000,000, the Company would be penalized when it has a positive balance in the deferred account and when it has a negative balance of less than $3,000,000. On the other hand, the customers would be penalized when the Company has a negative balance in the account of more than $3,000,000.

The Company objects to any adjustment to its rate base. Instead, the Company proposes to compute interest on the floating balance in the deferred account as suggested by the Commission in Order No. 95-1461 in Docket No. 95-160-G. More specifically, the Company proposes to compensate its customers for any funds actually provided by them by paying them interest at the legal rate of interest on the balance in the deferred account any time the account has a negative balance. Likewise, the Company proposes to charge interest to customers on the balance in the deferred account any time the account has a positive balance. The Commission agrees that the Company's proposal to pay interest is fair; however, the Commission believes that the interest rate should be equal to the Company's overall return. This interest rate would fully compensate both the Company and its customers whenever either of them provides funds for use in the Company's utility operations.

For all of the reasons stated above, the Commission finds and concludes that it would not be fair to the Company or to its customers to remove $3,000,000 from the Company's rate base as proposed by the Consumer Advocate. Instead, the Commission finds and concludes that the Company should compute interest on the floating balance in the deferred account at its overall rate of return in the matter set forth above.

4. Throughput Volumes.

To recognize the effect of the warmer-than-normal weather that occurred during the test period, the Company made a pro forma adjustment to increase sales to its weather sensitive firm customers and to reduce sales to its interruptible customers by a like amount during the winter period. Since firm customers pay higher rates, the effect of this adjustment was to reduce the amount of the rate increase requested in this case. The Consumer Advocate agrees with the Company's adjustment to increase firm sales, but contends that the Company should not have reduced its interruptible sales by a like amount during the winter period.

The Consumer Advocate supports his proposal by stating that common sense tells us that the Company will sell more gas when the weather is colder. In response, the Company points out that the question is not whether the Company will sell more gas when the weather is colder, but rather whether the Company will sell more gas in South Carolina when the weather is colder. The Company pointed out that because the ratio of interruptible sales to total sales in South Carolina is greater than it is in North Carolina, the Company may actually sell less gas in South Carolina when the weather is colder and interruptible customers in South Carolina are curtailed to provide service to firm customers in North Carolina. The Company also pointed out that its ability to increase its sales during colder weather depends upon a number of factors other than weather, including the available delivery capacity on the Company's distribution system, the time of year when the cold weather occurs, the amount of storage available when the cold weather occurs, and the pipeline capacity and gas supplies available to the Company when the cold weather occurs. The Company pointed out that this Commission, the North Carolina Utilities Commission and the Tennessee Public Service Commission have previously approved the weather normalization method proposed by the Company in this case. Finally, the Company argued that even if the Commission were to change the previously-approved procedures, the method proposed by the Consumer Advocate is flawed because it erroneously assumes that the relationship between degree days and curtailment of interruptible service is linear and limitless.

The Staff testified that it agreed with the weather normalization method used by the Company.

The Commission has carefully considered the arguments of the parties and finds and concludes that the weather normalization procedures used by the Company and supported by the Staff are appropriate and that the Consumer Advocate's adjustment must be rejected. As pointed out by the Company, the procedures used by the Company and supported by the Staff have previously been approved by this Commission, the North Carolina Utilities Commission and the Tennessee Public Service Commission. We also recognize that the adjustment proposed by the Consumer Advocate is flawed because it erroneously assumes a linear and a limitless relationship between degree days and interruptible sales. As pointed out by the Company, under certain conditions, throughput in South Carolina may actually decrease as the weather gets colder. Therefore, if we were to attempt to adopt some new method of predicting interruptible sales, we may find that the new method results in the calculation of less pro forma throughput and higher rates in South Carolina.

5. Depreciation Rates.

The Company proposed new depreciation rates in this proceeding. In support of its proposal, the Company filed a depreciation study conducted by Deloitte & Touche LLP. Company witness Barry Guy stated that the Company proposed to adjust its depreciation rates as recommended in the study with the exception of two accounts--Account No. 37600-Distribution Mains and Account No. 38000-Distribution Services. For these two accounts, the Company proposed the same rates as approved by the North Carolina Utilities Commission in 1994 in Docket No. G-9, Sub 77-E, rather than the higher rates recommended by the study. The Commission Staff agreed with the depreciation rates proposed by the Company.

The Consumer Advocate focused on five of the depreciation rates proposed by the Company: Account No. 39000-Structures & Improvements, Account No. 36700-Transporation Mains, Account No. 37600-Distribution Mains, Account No. 38000-Distribution Services and Account No. 38100-Distribution Meters; and the Consumer Advocate proposed to modify four depreciation rates proposed by the Company. No modification was proposed for Account No. 38100.

The Consumer Advocate points out that two of these accounts--Account No. 37600-Distribution Mains and Account No. 38000-Distribution Services--contain the greatest amount of plant and represent "the vast bulk (over 98%) of the increase in annual depreciation expense" proposed by the Company. At the hearing, Consumer Advocate witness Michael Ileo presented an exhibit to compare the Consumer Advocate's proposed depreciation rates with the rates contained in the Deloitte & Touche study. Dr. Ileo contended that the rates in the Deloitte & Touche study for these two accounts were excessive. On cross-examination, however, Dr. Ileo admitted that the depreciation rates proposed by the Company and for these two accounts were almost exactly in the middle of the depreciation rates proposed by Deloitte & Touche and the depreciation rates proposed by the Consumer Advocate.

The purpose of a depreciation study is to determine the reasonable useful life of the utility's property. Since it involves a great deal of judgment, there is no one correct depreciation rate. Thus, the Commission's task is to review the evidence and the conflicting recommendations, and determine which of those recommendations most accurately reflects the useful life of the Company's property. In performing this task, we note that Dr. Ileo's recommendations are based almost entirely upon his review of the Deloitte & Touche study and the responses to certain data requests. On cross-examination, Dr. Ileo admitted he did not review any of the Company's property, did not inspect the Company's property records, and did not talk to any of the Company's operating people concerning the actual condition of the Company's property. On the other hand, Donald Roff, testifying for the Company, testified that he did inspect the Company's property, that he did review the Company's property records and that he did discuss the Company's property with operating personnel.

In his prefiled direct testimony, Dr. Ileo refers to the "compounding impacts of the Iowa Curve and net salvage selections" and provides a discussion of the Gompertz-Makeham formula and the Fisher-Pry technology diffusion theory. Nevertheless, Dr. Ileo does not appear to use either the Gompertz-Makeham formula or the Fisher-Pry technology diffusion theory in his review of the Company's depreciation study. Furthermore, Mr. Roff testified that the types of property used to provide natural gas service and included in the asset base of the Company have limited, if any, technological turnover consistent with the application of the Fisher-Pry theory.

It appears that the major differences between Dr. Ileo and Mr. Roff relate to the determination of appropriate salvage value. For Account No. 38000, Dr. Ileo selects a negative 35% net salvage. Mr. Roff uses a 70% negative salvage factor. In support of his negative salvage factor, Mr. Roff testified that for the most recent five year period (1989-1993), the average net salvage ratio is greater than 72%. Mr. Roff also testified that the lowest net salvage ratio for the entire period 1971-1993 is a negative 40% in 1973 and that the average net salvage ratio for that entire period is negative 68.5%.

The net salvage factor used by the Company in its proposed depreciation rates is a negative 51.5%. This net salvage factor was recently approved by the North Carolina Utilities Commission.

The Commission finds and concludes that the depreciation rates proposed by the Company, accepted by the Staff and previously approved by the North Carolina Utilities Commission are appropriate for use in this case. On the two largest accounts on which there is a difference of opinion between the Consumer Advocate and

Deloitte & Touche, the Company has recommended depreciation rates which are in the middle of the two conflicting recommendations. The Commission believes that the company's proposal represents a fair and reasonable compromise and will avoid the effects of a sharp change in depreciation rates in this proceeding.

6. Customer Growth Factor.

Certain of the adjustments proposed by the Consumer Advocate had the effect of adjusting operating income; however, the Consumer Advocate did not make a corresponding adjustment to account for the Customer Growth Factor. At the hearing, the Consumer Advocate agreed that a corresponding adjustment to account for the Customer Growth Factor would be appropriate. The Commission has previously adopted a Customer Growth Factor of 4.12%, and that factor has been applied to operating income after all adjustments. Therefore, there is no need for further discussion of this issue.

7. Return on Common Equity.

The last issue affecting the Company's revenue requirement on which the Company and the Consumer Advocate disagree relates to the appropriate return on common equity. This item will be discussed below.

V. RATE BASE

While there is no express statutory requirement that the Commission determine the value of a gas utility's property devoted to the public service and give appropriate consideration to such property in the context of a ratemaking proceeding, this Commission has traditionally and consistently done so in general ratemaking proceedings involving gas utilities. We think this is appropriate in the present case also.

For ratemaking purposes, the rate base is the total net value of the gas utility's tangible capital or property value on which the gas utility is entitled to earn a fair and reasonable rate of return. The rate base, as derived in this proceeding, is composed of the value of the Company's property used and useful in providing gas service to the public, materials and supplies, and an allowance for cash working capital. The rate base computation incorporates reductions for accumulated depreciation, customer advances for construction, customer deposits, accumulated deferred income taxes and unclaimed funds.

In accordance with its standard practice, the Accounting Department of the Commission Staff conducted an audit and examination of the Company's books and verified all account balances from the Company's General Ledger, including rate base items, with plant additions and retirements. On the basis of this audit, the pertinent hearing exhibits and the testimony contained in the record of the hearing, the Commission can determine and find proper balances for the components of the Company's rate base as well as the propriety of related accounting adjustments.

When the rate base has been established, the Company's total operating income for return is applied to the rate base to determine what adjustments, if any, to the present rate structure are necessary to generate earnings sufficient to produce a fair rate of return. The rate base should reflect the actual investment made by investors in the Company's property and the value upon which stockholders will receive a return on their investment.

A. The Components of Rate Base.

1. Plant in Service.

This Commission has traditionally used the regulatory accounting methodology recognized as "original cost less depreciation" in the determination of the value of a gas utility's plant in service. The Commission finds and concludes that the appropriate amount of plant-in-service for use in this case is $179,801,706 determined as follows:

Plant-in-Service per Books	$169,146,388
Plus: Plant Additions through through July 31, 1995	10,607,136
Capitalization of OPEB expenses	53,434
Less: Vehicles Used for Non-Utility Operations	(5,252)
Total Plant-in-Service	$179,801,706

As previously discussed, the Company agreed to the Staff's adjustments of $10,601,884 to reflect plant additions actually occurring through July 31, 1995, and of ($5,252) to remove vehicles that are non-utility related. Also, as previously discussed, the Company agreed to the Consumer Advocate's adjustment to capitalize OPEB expenses. No other adjustment to plant-in-service was proposed by any party.

2. Accumulated Depreciation.

In determining the proper rate base for gas utilities, the Commission uses the gross plant in service dedicated to providing public service as reduced by the reserve for depreciation and amortization. The reserve represents that portion of the utility's depreciable properties which has been consumed by previous use and recorded as depreciation. The Commission finds and concludes that the appropriate amount of accumulated depreciation for use in this case is $42,540,940 determined as follows:

Accumulated Depreciation per Books	($40,928,607)
Staff's Adjustment to Annualize Depreciation Expense	(1,612,283)
Staff's Adjustment to Reallocate Company Vehicles	1,800
Consumer Advocate's Adjustment to OPEB Expenses	(1,850)
Total Accumulated Depreciation	($42,540,940)

The Company agreed to Staff's adjustments to annualize depreciation expenses and to recallocate certain company vehicles to non-utility activities. In addition, as previously discussed the Company agreed to the Consumer Advocate's adjustment to capitalize OPEB expenses. No other adjustment to accumulated depreciation was proposed by any party.

3. Construction Work in Progress.

This Commission has traditionally considered the reasonable and necessary costs of construction of utility plant not yet in service to be a proper rate base item. Such costs are described as "construction work in progress." The Commission finds and concludes that the appropriate amount of construction work in progress for use in this case is $699,813 determined as follows:

CWIP per Books	$2,965,955
Correction of Company Error	(21,163)
Staff's Adjustment to Reflect CWIP at 7-1-1995	(2,244,979)
Total CWIP	$ 699,813

The Company agreed to the Staff's adjustment to CWIP at July 31, 1995. No other adjustment to CWIP was proposed by any party.

4. Material and Supplies.

The Commission has traditionally considered "materials and supplies" to be a proper item to be included in a gas utility's rate base. The Commission finds and concludes that the appropriate amount of materials and supplies to be included in rate base in this case is $8,583,488. This amount includes natural gas stored. See discussion on pp. 13-15 supra.

5. Cash Working Capital.

The Commission considers an allowance for working capital to be an appropriate item for inclusion in the rate base of a gas utility. By permitting a working capital allowance, the Commission acknowledges the requirement for capital outlay related to the routine operations of the utility. For many years, the Commission has computed the allowance for working capital to be the sum of one-eighth of operation and maintenance expenses, minimum bank balances and prepayments, reduced by the amount of average tax accruals. The commission finds and concludes that the appropriate amount of cash working capital for use in this case is $1,435,384 determined as follows:

Cash Working Capital per Books	$1,463,553
Staff's Adjustment to Reflect O&M Expense Adjustments	(28,169)
Total Cash Working Capital	$1,435,384

The Company agreed to the Staff's adjustment to reflect changes in O&M expenses. As previously discussed, the Commission does not accept the Staff's proposed adjustment to remove cash working capital associated with imprest bank accounts, petty cash and employee travel advances. No other adjustment to cash working capital was proposed by any party.

6. **Customer Advances for Construction.** Customer Advances for Construction represents a component upon which the Commission considers investors are not entitled to earn a return. The Commission finds and concludes that the appropriate amount of Customer Advances for Construction for use in this case is $500. The Company proposed this amount, and no party proposed any adjustments to this amount.

7. **Customer Deposits.**

The amount representing Customer Deposits also is considered by this Commission to be an element on which the Company's investors are not entitled to earn a return and which should be excluded from he Company's rate base. The Commission finds and concludes that the appropriate amount of Customer Deposits for use in this case is $1,316,185. The Company proposed this amount, and no party proposed any adjustments to this amount.

8. **Accumulated Deferred Income Taxes.**

Accumulated Deferred Income Taxes constitute a form of cost-free capital, and, consequently, an element upon which the Commission feels investors are not entitled to earn a rate of return. The per books amount for Accumulated Deferred Income Taxes was $16,675,127. No party proposed any adjustment to this amount; therefore, the Commission finds and concludes that this amount is the appropriate amount for Accumulated Deferred Income Taxes in this proceeding.

9. **Unclaimed Funds.**

Unclaimed Funds are cost-free capital and should not be included in rate base. The per books amount for Unclaimed Funds was $103,902. No party proposed any adjustment to this amount; therefore, the Commission finds and concludes that this amount is the appropriate amount for Unclaimed Funds for use in this proceeding.

B. Original Cost Rate Base

The Company's rate base for its gas operations herein adjusted and determined by the Commission to be appropriate for the purposes of this proceeding, is set forth in the following table:

Table A

Original Cost Rate Base

Gross Plant in Service	$179,801,706
Accumulated Depreciation	(42,540,940)
Net Plant in Service	137,260,766
Construction Work in Progress	699,813
Materials and Supplies	8,583,488
Cash Working Capital	1,435,384
Customer Advances for Construction	(500)
Customer Deposits	(1,316,185)
Accumulated Deferred Income Taxes	(16,675,127)
Unclaimed Funds	(103,902)
Total Rate Base	$129,883,737

VI. CAPITAL STRUCTURE

The Staff proposed the following capital structure:

Table B

CAPITALIZATION

Long-Term Debt	$309,379,166	45.81%
Common Equity	$366,040,240	54.19%
Total	$675,419,406	100.00%

This capital structure represents the Company's actual capital structure at July 31, 1995. The Company and Staff have agreed to the use of this capital structure. The Consumer Advocate accepted the Company's filed pro forma capital structure of 45.83% Long-Term Debt and 54.17% Common Equity. Considering the fact that the consumer Advocate accepted the Company's pro forma capital structure, the fact that the Company has now agreed to the use of the actual capital structure at July 31, 1995, and the fact that the actual capital structure at July 31, 1995, and the pro forma capital structure are virtually identical, the Commission finds and concludes that the capital structure at July 31, 1995, as set forth in Table B is the appropriate capital structure for use in this proceeding.

VII. COST OF CAPITAL

A. Long-Term Debt.

The Company, the Staff and the Consumer Advocate all used an embedded cost of long-term debt of 8.72%, which was the actual embedded cost of long-term debt at January 31, 1995 and July 31, 1995. The Commission finds and concludes that 8.72% is the appropriate embedded cost of long-term debt to use for the purpose of this proceeding.

B. Common Equity.

Based on the adjustments approved herein, the Company's present rates would enable the Company to earn a return on its common equity of 12.50%. The Company originally sought the approval of rates which would give it a reasonable opportunity to earn a return on common equity of 13.50%. At the hearing, the Company lowered its request to 13.00%.

Three witnesses offered testimony as to the appropriate cost of the Company's common equity. Company witness Dr. Donald Murry testified that the Current cost of the Company's common equity is 13.00%. Commission Staff witness Dr. James Spearman testified that the current cost of the Company's common equity is between 11.25% to 11.75%. Consumer Advocate witness David Parcell testified that the current cost of the gas distribution company groups is 10.75% to 11.75%, but he reduced the Company's common equity by .25% to reflect the fact that the Company has a weather normalization adjustment provision. The Company strongly objected to any adjustment to the rate of return, because of the weather normalization adjustment provision.

The Commission cannot determine the fair and reasonable return on common equity for the Company in isolation. Rather, the Commission must carefully consider a variety of relevant factors, including identifiable trends in the market relating to the costs of labor, materials and capital, comparisons of past earnings with present earnings and prospective earnings; the prices for which the Company's service must be rendered; the returns of other enterprises and the reasonable opportunities for investment therein; the financial policy and capital structure of the Company and its ability to attract capital; the competency and efficiency of the Company's management; the inherent protection against competition afforded the Company through the operation of the regulatory process; and the public demand for growth and system expansion which is required to evaluate the construction program for the foreseeable future. The Commission must strike a balance among these complex factors in the context of the record herein.

The Commission recognizes the necessity that the Company be allowed the opportunity to earn a fair return sufficient to enable the Company to continue to meet its service obligations and to maintain its financial strength for the future. In that connection, the Commission recognizes that the Company has had an aggressive construction program, has increased its South Carolina gas plant by 42.59% since its last rate case, and has raised substantial amounts of capital to finance these additions.

As an integral part of the process, the Commission must weigh the interests of the Company's customers in regard to the price of natural gas service with the interest of the same customers in regard to the reliability and adequacy of the supply of natural gas. We have kept those interests paramount through this proceeding.

The Commission recognizes the legal principle and the practical necessity that the Company be allowed the opportunity to earn a fair rate of return to enable it to continue to meet its service obligations and to maintain its financial strength to provide for the attraction of capital.

In its determination of a fair and reasonable rate of return, the Commission maintains the ultimate responsibility of setting the rates to be charged for the utility services provided by the Company. The exercise of that responsibility involves the balancing of the interest of the consumer and the investor. The Commission must balance the interest of the consumer in regard to the price of utility service with the interests of the same consumer in regard to the reliability and adequacy of the supply of energy. The Commission has maintained these interests paramount throughout this proceeding. The Commission's determinations of the Company's revenue requirements and of the proper allocation of those revenues within the approved rate structure embodied in this Order reflect fairly and equitably both the interests of those consumers and the interests of the Company.

In light of all relevant issues in the record of this proceeding, the Commission is of the opinion, and so finds, that a fair and proper return on common equity 12.50%, which is produced by additional annual revenues of $7,807,207 for the Company's gas operations, as approved infra, is fair and reasonable.

The rate of return on common equity herein found fair and reasonable falls in between he analyses conducted by Dr. Murry on the one hand, and Dr. Spearman and Mr. Parcell on the other. Although all these analyses have merit, we believe that Dr. Murry's analysis slightly overstates the cost of equity, and Dr. Spearman's and Mr. Parcell's analyses slightly understate the cost of equity. We believe that a reasonable expectation for the potential equity investor is actually incorporated by a figure in between the analyses, i.e. 12.50%. We do disagree with Mr. Parcell that the Company's common equity should be reduced by .25% to reflect the fact that the Company has a weather normalization adjustment provision. We do not believe that such an adjustment is appropriate.

We do hold, however, that 12.50% is fair and reasonable, and is sufficient to protect the financial integrity of the Company, to preserve the property of the investor, and to permit the Company to continue to provide reliable service to present and future customers at reasonable rates.

VIII. Rate of Return.

An important function of ratemaking is the determination of the overall rate of return which the utility should be granted. This Commission has utilized the following definition of "rate of return" in previous decisions, and continues to do so in this proceeding:

> For regulatory purposes, the rate of return is the amount of money earned by a regulated company, over and above operating costs, expressed as a percentage of the rate base. In other words, the rate of return includes interest on long-term debt, dividends on preferred stock, the earnings on common stock and surplus. As Garfield and Lovejoy have put it "the return is that money earned from operations which is available for distribution among various classes of contributors of money capital. In the case of common stockholders, part of their share may be retained as surplus."
>
> Phillips, The Economics of Regulation, pp. 260-261 (1969).

The United States Supreme Court's landmark decision in Bluefield Water Works and Improvement Co. v Public Service Commission of West Virginia, 262 U.S. 679 (1923), delineated general guidelines for determining the fair rate of return in utility regulation. In the Bluefield decision, the Court said:

> What annual rate will constitute just compensation depends upon many circumstances and must be determined by the exercise of a fair and enlightened judgment, having regard to all relevant facts. A public utility is entitled to such rates as will permit it to earn a return on the value of the property which it employs for the convenience of the public equal to that generally being made at the same time and in the same general part of the country on investments in other business undertakings which are attended by corresponding risk and uncertainties; but it has no constitutional rights to profits such as are realized or anticipated in highly profitable enterprises or speculative ventures. The return should be reasonably sufficient to assure confidence in the financial soundness of the utility and should be adequate under

> efficient and economical management, to maintain and support its credit and enable it to raise the money necessary for the proper discharge of its public duties. A rate of return may be reasonable at one time, and become too high or too low by changes affecting opportunities for investment, the money market, and business generally.
>
> 262 U.S. at 692-693.

During the subsequent years, the Supreme Court refined its appraisal for regulatory precepts. In its frequently cited Hope decision, supra, the Court restated its views:

> We held in Federal Power Commission v. Natural Gas Pipeline Co... that the Commission was not bound to the use of any single formula or combination of formulae in determining its rates. Its ratemaking function, moreover involves the making of "pragmatic adjustments" (cite omitted)... Under the statutory standard of "just and reasonable" it is the result reached, not the method employed which is controlling (citations omitted)...
>
> The ratemaking process under the Act, i.e., the fixing of "just and reasonable" rates involves a balancing of the investor and the consumer interest. Thus we stated in the Natural Gas Pipeline Co. case, that regulation does not insure that the business shall produce net revenues. (citation omitted).
>
> But such considerations aside, the investor interest has a legitimate concern with the financial integrity of the company whose rates are being regulated. From the investor or company point of view it is important that there be enough revenue not only for operating expenses but also for the capital costs of the business. These include service on the debt and dividends on the stock. (citation omitted). By that standard the return to the equity owner should be commensurate with returns on investments in other enterprises having corresponding risks. That return, moreover, should be sufficient to assure confidence in the financial integrity of the enterprise, so as to maintain its credit and to attract capital.
>
> 320 U.S. at 602-603.

The validity of these decisions has not been eroded, as indicated by the language of the more recent decision of the

Supreme Court in In Re: Permian Basin Area Rate Cases, 390 U.S. 747 (1968). This Commission has consistently operated within the guidelines set forth in the Hope decision. See also, Southern Bell, supra, 244 S.E.2d at 280-83.

The rate of return which the Commission has herein found to be fair and reasonable should enable the Company to maintain its levels of good service and preserve its financial integrity. Patently, however, the Company must insure that its operation and maintenance expenses remain at the lowest level consistent with reliable service and exercise appropriate managerial efficiency in all phases of its operations. The Commission has consistently manifested its abiding concern for the establishment and continuation of efficiency programs on the part of its jurisdictional entities. The Commission reiterates its consistent statement that we are not inclined to be completely satisfied with the cost reduction and efficiency programs of any jurisdictional entity. Consequently, the Commission will continue to expect the Company to design and implement such programs in the future as an index of good management practice in the interest of its customers and of the Company itself.

In this Order, we have previously found that the capitalization ratios set forth in Table B are appropriate and should be used for ratemaking purposes herein. The Commission finds that the embedded cost rate for long-term debt of 8.72% is fair and reasonable for use in this proceeding. For the purposes of this proceeding, the Commission has herein found the proper cost rate for the Company's common equity capital to be 12.50%.

Using these findings, the overall rate of return on rate base for the Company's South Carolina operations may be derived as computed in the following table:

TABLE C

Overall Rate of Return

	Ratio	Cost	Weighted Cost
Long-Term Debt	45.81%	8.72%	3.99%
Common Equity	54.19%	12.50%	6.78%
Total	100.00%		10.77%

IX. Revenue Requirements.

The Company's total income for return after accounting adjustments and prior to any rate adjustment, for its South Carolina operations, is $9,010,067. This amount, when divided by the Company's rate base of $129,883,737 as calculated in Table A, produces a rate of return on rate base of 6.94%, as of January 31, 1995.

In order to achieve an overall rate of return on its South Carolina operations at the level of 10.77%, which this Commission has found to be appropriate and reasonable for the test year period for the reasons previously indicated, the Company will require additional revenues of $7,807,277 from its South Carolina operations.

Total income for return, both before and after the approved increase, as found by the Commission, is illustrated as follows:

TABLE D

Total Income for Return

Before Rate Increase	Total
Net Operating Income	$8,590,896
Customer Growth	354,129
AFUDC	65,042
Total Income for Return	$9,010,067

After Rate Increase	
Net Operating Income	$13,370,410
Customer Growth	551,147
AFUDC	65,042
Total Income for Return	$13,986,599

X. Allocation of Revenues.

The revenue requirements of the Company having been determined, the Commission is also concerned with the determination of the specific rates and the development of the rate structure that will yield the required revenues. It is generally accepted that proper utility regulation requires the exercise of control over the rate structure to ensure that equitable treatment is afforded each class of customer.

The three primary criteria of a sound rate structure have been set forth as follows:

> ...(a) the revenue-requirement or financial-need objective, which takes the form of a fair-return standard with respect to private utility companies; (b) the fair-cost apportionment objective which invokes the principle that the burden of meeting total revenue requirements must be distributed <u>fairly</u> among the beneficiaries of the service, and (c) the optimum-use or consumer rationing objective, under which the rates are designed to discourage the wasteful use of public utility services while promoting use that is economically justified in view of the relationships

between costs incurred and benefits received.

Bonbright, Principles of Public Utility Rates (1961), p. 292.

These criteria stated above have been used by this Commission in past cases and are utilized again in this proceeding.

In approving the increases and decreases in the Company's various classes of service, the Commission has undertaken to recognize and reconcile the Commission's consistent ratemaking objectives to meet the revenue requirements found fair and reasonable. The Commission has considered the revenue increases and decreases for each class of service shown in Table E, infra, and finds the same to be fair and reasonable, and appropriate for this proceeding.

TABLE E

Approved Increase (Decrease) by Class

Class of Service	Approved Increase (Decrease)
Residential (Rate 201)	$4,569,927
General (Rate 202)	2,044,506
Large General (Rate 203)	869,981
Interruptible (Rate 204)	(112,992)
Outdoor Gas Light (Rate 205)	102
Large General Transportation (Rate 213)	355,976
Interruptible Transportation (Rate 214	79,707
Total Increase	$7,807,207

Company witness Ware Schiefer testified that in the Company's design of rates it considered traditional rate design principles, the results of a cost of service study and the need to remain competitive. The "traditional rate design principles" included value of service, the need to avoid discrimination among classes of service, system load equalization and revenue stability.

Mr. Schiefer testified that the cost of service study shows that under existing rates all classes of residential customers are contributing a negative return, while all non-residential customers provide returns above system average. Therefore, the Company deemed it to be crucial that residential schedules be adjusted so that they would contribute a greater return.

Mr. Schiefer also testified that the Company's facilities charges should be increased to be more closely aligned with costs. He testified that even with the increase in facilities charges being proposed by the Company, the facilities charge would still recover only 25% of the fixed charges associated with serving the year-round residential customers and only 31% of the fixed charges associated with serving the heating-only residential customers. He pointed out that because the existing facilities charges are so low, the Company's commodity rates are often not competitive with natural gas authorities and municipal systems that compete with the Company in South Carolina.

The Company proposed to increase residential rates by approximately 15%, to increase the rates to non-residential firm customers by 8% to 10% and to reduce rates to interruptible sales and transportation customers by 4.8%. In support of the reduction to the interruptible customers, Mr. Schiefer pointed out that under current rates (a) this class of customer produces a return in excess of 70%, (b) the Company had to reduce its rates to these customers by $3.8 million through negotiation during the test period, (c) the existing rates places the Company and the upper state region of South Carolina at a disadvantage when competing for new or expanded industry and (d) the existing rates place the Company at the risk of by-pass.

Consumer Advocate witness Glenn Watkins testified that, in his opinion, the Company's cost of service study does not correctly allocate expenses and rate base among the various customer classes; however, he did not prepare a cost of service study, nor did he show what the returns for any class of customer would be if expenses and rate base had been allocated as suggested by him. Despite his criticism of the Company's cost of service study, he recognized that the residential class of customers is not carrying its fair share of the costs. He recommended that the percentage increase to the residential class of customers be equal to 150% of the approved Company-wide increase. He also recommended an increase in the residential facilities charge from $3.00 to $3.50.

The Commission has carefully considered the entire record and believes that the rates attached hereto as Appendix A are fair and reasonable.

XI. WNA FACTORS AND ALLOCATION OF GAS COSTS.

The operation of the Company's Gas Recovery Mechanism and Weather Normalization Adjustment factors require that we allocate demand gas costs to each rate schedule and that we establish the "R" values and heat factors to be used in the Company's Weather Normalization Adjustment (WNA). The Company was the only party to present any evidence of this requirement, and we find and conclude that the allocation of demand gas costs and WNA factors set forth in Appendix B attached herein are appropriate.

XII. FINDINGS AND CONCLUSIONS.

Based upon the foregoing considerations and after a full review of the testimony, exhibits and complete record in this proceeding, the Commission has made the following findings and reached the following conclusions concerning the operations, the rate of return and the reasonable earnings requirements to be allowed the Company:

1. That Piedmont Natural Gas Company, Inc., is a gas utility and is subject to the jurisdiction of this Commission, pursuant to S.C. Code Ann.§§58-5-10, et seq. (Law Co-op. 1977);

2. That the appropriate test period for the purposes of this proceeding is the twelve-month period ended January 31, 1995;

3. That the Company in its Application is seeking an increase in rates and charges to certain customers in this proceeding that will produce additional revenues for the test year period of $8,827,414;

4. That an end of test year, original cost rate base of $129,883,737 consisting of the components set forth in Table A of this Order should be adopted for ratemaking purposes;

5. That the capital structure set forth in Table B of the Order should be adopted for this proceeding;

6. That the rate of return on the Company's operations, during the test year, after accounting and pro forma adjustments, and prior to any rate adjustments, was 6.94%;

7. That a fair and proper return on common equity for the Company is 12.50% which will be produced by the additional revenues of $7,807,207 which are fair and reasonable;

8. That the Company's embedded cost of long-term debt of 8.72% and a cost of common equity of 12.50% should be used in the determination of a fair overall rate of return;

9. That the accounting and pro forma adjustments set forth in Section IV of this Order are reasonable and proper;

10. That the total income for return after accounting and pro forma adjustments and prior to rate adjustments, was $9,010,067 for the test period, and that such amount of income is insufficient based on the reasonable rate of return found in this proceeding;

11. That approval should be given for rates and charges which will provide additional gross revenues to the Company of $7,807,207 on its gas operations, which will produce an additional total income for return of $4,976,533;

12. That the additional revenues allowed would produce a rate of return on approved rate base of 10.77% which is found to be fair and reasonable in this proceeding;

13. That such additional revenues and the return which these revenues produce are well within the range of reasonableness and fairness and must be provided if the Company is to meet all of its customer requirements;

14. That the additional revenues would provide a rate of return on common equity of 12.50%;

15. That the schedule of rates and charges attached hereto as Appendix A are fair and reasonable and should be approved for service rendered on and after the date of this Order;

16. That the schedule of WNA factors and allocation of costs of gas attached hereto as Appendix B are fair and reasonable and

should be approved for service rendered on and after the date of this Order;

17. That the Company should file with the Commission for approval within fifteen (15) days from the date of this Order, rate schedules which reflect the rates contained in Appendix A and tariffs reflecting the findings contained herein;

18. That the Company should continue to file with this Commission, as previously ordered, quarterly reports showing:

(1) Rate of return on rate base;

(2) Return on common equity;

(3) Earnings per share of common stock; and

(4) Debt coverage ratio of earnings to fixed charges.

IT IS THEREFORE ORDERED:

1. That the proposed rate schedules filed by the Company on May 8, 1995, are not fair and reasonable.

2. That the rates set forth in Appendix A hereto are reasonable and proper and are hereby approved.

3. That the WNA factors and allocation of costs of gas attached hereto in Appendix B are fair and reasonable and are hereby approved.

4. That the Company file all reports herein identified in accordance with the findings contained herein.

RATE SCHEDULE 201
Residential Service

Heat Only	
Facilities Charge	$ 3.50
Winter (Nov - Mar)	.71670 per therm
Summer (Apr - Oct)	.62950 per therm
Year Round	
Facilities Charge	$ 3.50
Winter (Nov - Mar)	.67950 per therm
Summer (Apr - Oct)	.62950 per therm
Public Housing	
Facilities Charge	$ 0.00
Winter (Nov - Mar)	.67950 per therm
Summer (Apr - Oct)	.62950 per therm

RATE SCHEDULE 202
Small General Service

Facilities Charge	$ 10.00
Winter (Nov - Mar)	
First 1,000 therms	.65000 per therm
Next 4,000 therms	.60500 per therm
Next 10,000 therms	.53000 per therm
Over 15,000 therms	.46000 per therm
Summer (Apr - Oct)	
First 1,000 therms	.54500 per therm
Next 4,000 therms	.49500 per therm
Next 10,000 therms	.42500 per therm
Over 15,000 therms	.37500 per therm

RATE SCHEDULE 202-A
General Service - Air Conditioning

Facilities Charge $ 10.00

$.07500 per therm discount off Rate Schedule 202 for usage during the months of May through September.

RATE SCHEDULE 202-B
General Service Motor Fuel

Facilities Charge	$ 25.00
Winter (Nov - Mar)	.38500 per therm
Summer (Apr - Oct)	.38500 per therm

RATE SCHEDULE 203
Large General Service

Facilities Charge	$150.00
Winter (Nov - Mar)	
First 1,000 therms	.65000 per therm
Next 4,000 therms	.60500 per therm
Next 10,000 therms	.53000 per therm
Over 15,000 therms	.46000 per therm
Summer (Apr - Oct)	
First 1,000 therms	.54500 per therm
Next 4,000 therms	.49500 per therm
Next 10,000 therms	.42500 per therm
Over 15,000 therms	.37500 per therm

RATE SCHEDULE 204
Interruptible Service

Facilities Charge	$250.00
Winter (Nov - Mar)	
First 15,000 therms	.37945 per therm
Next 15,000 therms	.37945 per therm
Next 75,000 therms	.36445 per therm
Next 165,000 therms	.34945 per therm
Next 330,000 therms	.33945 per therm
Over 600,000 therms	.33445 per therm
Summer (Apr - Oct)	
First 15,000 therms	.35445 per therm
Next 15,000 therms	.34445 per therm
Next 75,000 therms	.33445 per therm
Next 165,000 therms	.31945 per therm
Next 330,000 therms	.30445 per therm
Over 600,000 therms	.27026 per therm

RATE SCHEDULE 205
Outdoor Gas Light Service

Each fixture connected $10.00 per month.

RATE SCHEDULE 213
Large General Transportation Service

Facilities Charge	$225.00
Winter (Nov - Mar)	
First 1,000 therms	.43055 per therm
Next 4,000 therms	.38555 per therm
Next 10,000 therms	.31055 per therm
Over 15,000 therms	.24055 per therm
Summer (Apr - Oct)	
First 1,000 therms	.32555 per therm
Next 4,000 therms	.27555 per therm
Next 10,000 therms	.20555 per therm
Over 15,000 therms	.15555 per therm

RATE SCHEDULE 214
Interruptible Transportation Service

Facilities Charge	$325.00
Winter (Nov - Mar)	
First 15,000 therms	.16000 per therm
Next 15,000 therms	.16000 per therm
Next 75,000 therms	.14500 per therm
Next 165,000 therms	.13000 per therm
Next 330,000 therms	.12000 per therm
Over 600,000 therms	.11500 per therm
Summer (Apr - Oct)	
First 15,000 therms	.13500 per therm
Next 15,000 therms	.12500 per therm
Next 75,000 therms	.11500 per therm
Next 165,000 therms	.10000 per therm
Next 330,000 therms	.08500 per therm
Over 600,000 therms	.05081 per therm

Appendix B

	Base Rate ($/therm)	Demand ($/therm)	Commodity ($/therm)	R Value ($/therm)	Heat Factor (therms/DDD)	Base Factor (therms/mo.)
Residential						
Rate Schedule 201-Year Round	0.67950	0.07650	0.22321	0.37979	0.18864	15.99796
Rate Schedule 201-Heating Only	0.71670	0.07650	0.22321	0.41699	0.18572	2.92301
Rate Schedule 201-Public Housing	0.67950	0.07650	0.22321	0.37979	0.13091	26.95780
Commercial						
Rate Schedule 202-Small Commercial						
First 1,000 therms	0.65000	0.07650	0.22321	0.35029	0.71893	182.74342
Next 4,000 therms	0.60500	0.07650	0.22321	0.30529	0.71893	182.74342
Next 10,000 therms	0.53000	0.07650	0.22321	0.23029	0.71893	182.74342
All over 15,000 therms	0.46000	0.07650	0.22321	0.16029	0.71893	182.74342
Industrial						
Rate Schedule 203 & 213						
First 1,000 therms		0.07635				
Next 4,000 therms		0.07635				
Next 10,000 therms		0.07635				
All over 15,000 therms		0.07635				
Rate Schedule 204 & 214						
Winter						
First 15,000 therms		0.08727				
Next 15,000 therms		0.08454				
Next 75,000 therms		0.07636				
Next 165,000 therms		0.06818				
Next 330,000 therms		0.06272				
All over 600,000 therms		0.05454				
Summer						
First 15,000 therms		0.06272				
Next 15,000 therms		0.05727				
Next 75,000 therms		0.05181				
Next 165,000 therms		0.04363				
Next 330,000 therms		0.03545				
All over 600,000 therms		0.01636				

5. That this Order shall remain in full force and effect until further Order of the Commission.

BY ORDER OF THE COMMISSION:

Rudolph Mitchell
Chairman

ATTEST:

Mary E Walsh
Deputy Executive Director

(SEAL)